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In the Supreme Court of the United States

OCTOBER TERM, 1957

No. 97

UNITED STATES OF AMERICA, PETITIONER

v.

R. F. BALL CONSTRUCTION COMPANY, INC., AND UNITED PACIFIC INSURANCE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The memorandum decision of the District Court (R. 7–14) is reported at 140 F. Supp. 60. The *per curiam* opinion of the Court of Appeals (R. 23) is reported at 239 F. 2d 384.

JURISDICTION

The judgment of the Court of Appeals (R. 24) was entered on December 26, 1956. By order of Mr. Justice Black on March 21, 1957, the time for filing a petition for certiorari was extended to April 5, 1957. (R. 24.) The petition for a writ of certiorari was filed on April 5, 1957, and was granted on May 13,

1957. (R. 25.) The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

QUESTIONS INVOLVED

1. Whether the assignee of an unborn account receivable assigned as collateral security for the payment of an indebtedness not even in potential existence at the time of the assignment is a "mortgagee" (or "pledgee") within the meaning of Section 3672 of the Internal Revenue Code of 1939.

2. Whether an allowance of attorney's fees to an interpleader (the debtor of the taxpayer-assignor) is entitled to priority in the interpleaded fund as against a federal tax lien which had previously attached to the fund.

STATUTES INVOLVED

The pertinent provisions of Sections 3670, 3671, and 3672 (a) of the Internal Revenue Code of 1939, Article 260–1 of 1 Vernon's Civil Statutes of the State of Texas, Annotated, and Article 5490, 16 Vernon's Civil Statutes of the State of Texas, Annotated, are set forth in the Appendix, *infra*, pp. 27–29.

STATEMENT

This action originated in the District Court of Bexar County, 57th Judicial District of Texas, by the filing of a petition of interpleader by R. F. Ball Construction Company, Inc. (one of the respondents herein). Ball's petition was accompanied by a tender of payment into the registry of court of a fund in the amount of $13,228.55 on behalf of Marcus M. Jacobs

Company, Inc. (the taxpayer),[1] a creditor of Ball. The petition alleged that the suit was one to quiet title to personal property claimed by (among others) the United States and the United Pacific Insurance Company (the other respondent), both of whom were named as party defendants. The petition also prayed for the allowance to Ball of attorneys' fees of $500 out of the interpleaded fund. (R. 4, 17.) On motion of the United States, the case was removed to the United States District Court for the Western District of Texas. (R. 18.)

The pertinent facts, as stipulated (R. 1–6) and as found by the District Court (R. 15–19), may be summarized as follows:

On June 26, 1951, Ball entered into a contract with the Housing Authority of the City of San Antonio, Texas, for the construction of a housing project (TEX 6–10). On July 17, 1951, Ball subcontracted a portion of the work to taxpayer and required of it a performance bond.[2] (R. 15.)

On July 21, 1951, taxpayer applied to the respondent bonding company for a bond payable to Ball, and, as part of the application, assigned to the bonding company, "*as collateral security for* the full performance of the covenants and agreements herein contained and *the payment of any other indebtedness or liability*

[1] Prior to October 1, 1951, taxpayer company was organized as a partnership. On that date, the partnership incorporated, and the corporation succeeded to all of the rights and liabilities of the partnership. (R. 16.) For convenience, both the partnership and the corporation will be referred to as taxpayer.

[2] This bond also covered another housing project (TEX 6–7). (R. 2.)

of the undersigned to the Company, whether heretofore or hereafter incurred" (emphasis added), all of their right to any sums which might become due to them under the subcontract with Ball.[3] The bond was executed on July 23, 1951. (R. 15–16).

On April 4, 1952, taxpayer applied to the bonding company for a similar performance bond payable to the Darby and Perkins Construction Companies covering a subcontract in Louisville, Kentucky. In the application, taxpayer agreed to indemnify the bonding company against all loss which might be incurred as a result of writing the bond. The bond was executed pursuant to the application, and between December 1953 and March 1954 the bonding company, as surety, was required to make payments totaling $12,971.88 on the Kentucky contract. (R. 16.)

The Government's liens for federal withholding and social security taxes assessed against taxpayer arose in March and May of 1953, when the assessment lists were received by the District Director, and notices of these tax liens totaling $17,010.85 were filed in May, June, and September of 1953. (R. 16–17.)

In determining the priorities among the parties[4] to the fund paid into court by Ball, the United States

[3] Under the terms of the subcontract, Ball was to retain ten per cent of the value of the completed work at all times until Ball's work had been accepted by the Housing Authority, at which time the ten per cent retained fund would be paid to taxpayer. (R. 16.)

[4] In addition to the claims presented by Ball, the United States, and the bonding company, two claims were presented by Herweck Company, Inc. (a materialman) and S. H. Kottwitz (an unsecured creditor). The Kottwitz company failed to prosecute its claim, and the bonding company agreed to satisfy

District Court held: (1) that Ball (claiming interpleader's attorneys' fees) was entitled to recover the sum of $500; (2) that the bonding company (claiming reimbursement for losses sustained in connection with the Kentucky bond) was entitled to recover the remainder of the fund, less court costs; and (3) that the United States (claiming under the tax liens) was not entitled to any recovery.[5] (R. 19.)

In a *per curiam* opinion, the Court of Appeals affirmed the judgment of the District Court for the reasons set forth in the latter's opinion. (R. 23.)

SUMMARY OF ARGUMENT

I

A. The court below erred in holding that taxpayer's assignment of unearned, though potential, income under the Texas contract was a mortgage within the scope of Section 3672 of the Internal Revenue Code of 1939, and that the assignment secured, as of the date of its execution, the indebtedness which subsequently arose under an entirely different and unrelated contract (the Kentucky contract). The term "mortgagee" as used in Section 3672 is to be understood in its conventional sense. In that sense, a mortgage must not only be security for a debt to which it is collateral,

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the Herweck Company claim in the event it should prevail, thus eliminating (under the court's ruling) the necessity for determining the priority of that claim. Default judgments were also entered against other creditors. (R. 8–9.)

[5] It also rendered judgment against the Kottwitz and Herweck companies (see note 4, *supra*) and declared "final" the default judgments previously rendered against various claimants. (R. 20.)

but there must also be in existence specific property to which the mortgage lien can attach. Here, at the time taxpayer assigned the unearned income under the Texas contract, he had nothing to assign; neither was he indebted to the respondent surety company at that time. Hence, at the time of its execution, the assignment was not a mortgage.

Even if the assignment be deemed as intended to effect a mortgage of after-acquired property, it was of no legal effect as such until an indebtedness arose several years later in consequence of the default under the Kentucky contract. Until that time, the *amount* of the lien was not known and could not have been determined from the vague reference in the assignment to "any other indebtedness." Until that indebtedness had been determined, the bonding company had at most only an inchoate and unperfected lien. Prior to that time, however, all the federal tax liens had arisen and were recorded. In such circumstances, the priority of the federal liens is clear from several recent decisions of this Court holding, *inter alia*, that an adverse lien must be specific and perfected at the time the tax lien arises in order to prime a federal tax lien and that the doctrine of relation-back cannot operate to destroy the realities of the situation.

B. Nor is the purported assignment a pledge in its conventional sense. There was no transfer of possession, either actual or constructive, of property or collateral sought to be pledged as security.

II

The courts below also erred in allowing an attorney's fee to be paid to the interpleader's attorney out

of the fund in question. Since the fund was impressed with a prior and perfected lien of the United States, attorney's fees arising thereafter are subordinate to the Government's liens. In this aspect, the case is controlled by *United States* v. *Liverpool & London Ins. Co.*, 348 U. S. 215.

ARGUMENT

I

A FEDERAL TAX LIEN IS SUPERIOR TO AN INCHOATE LIEN BASED UPON THE ASSIGNMENT OF AN UNBORN ACCOUNT RECEIVABLE AS COLLATERAL SECURITY FOR A CONTINGENT OBLIGATION WHICH DID NOT RIPEN INTO INDEBTEDNESS UNTIL AFTER THE RECORDING OF THE FEDERAL LIEN

The principal question to be determined in this case involves the relative priority to be accorded a surety's claim based upon the assignment of an unborn account receivable, as against certain federal tax liens which arose under the provisions of Sections 3670 and 3671 of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 27).

Section 3670 provides that, if any person liable to pay any tax neglects or refuses to pay the same after demand, the amount "shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." Section 3671 provides that, unless another date is specifically fixed by law, "the lien shall arise at the time the assessment list was received by the collector [District Director] and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time."

Accordingly, the tax liens here involved arose on March 16, May 14, and May 15, 1953, the dates on which the District Director received the assessment lists assessing the taxes involved in the total amount of $17,010.85. (R. 16–17.) When, on April 30, 1953, the Housing Authority accepted the work under the Texas contract, taxpayer became entitled to receive the sum of $13,228.55, representing the retained percentages under its subcontract with the Ball Construction Company. Consequently, as of May 15, 1953, when the last of the three tax liens arose, the Government had perfected tax liens on the $13,228.55 debt owed by Ball to taxpayer. *United States* v. *New Britain*, 347 U. S. 81. Notices of these federal liens, moreover, were filed in May, June, and September, 1953.

The assignment, under which the bonding company claims, was made on July 21, 1951, in connection with the issuance of a bond pertaining to a building subcontract to be performed by the taxpayer in Texas. It was executed some nine months prior to issuance of another bond pertaining to an entirely different contract to be performed by taxpayer in Kentucky. As stated above, that Texas contract was completed on April 30, 1953, and taxpayer incurred no liability thereunder for which the bonding company was liable. But taxpayer defaulted under the Kentucky contract, and between December 1953 and March 1954—about two and a half years after execution of the Texas bond on July 23, 1951—the bonding company was required to make payments under the bond relating to the Kentucky contract in the amount of $12,971.88.

(R. 15–16). The bonding company then sought repayment on the basis of the taxpayer's assignment made in connection with the Texas bond.

That assignment, after reciting that all sums which might become due taxpayer under the Texas contract were assigned to the bonding company for the full performance of the covenants and agreements therein contained, further recited that such sums were also assigned "as collateral security for * * * the payment of any other indebtedness or liability of the undersigned [taxpayer] to the Company, whether heretofore or hereafter incurred."[6] (R. 15.) The phrase "other indebtedness," as construed by the courts below,[7] is in no way limited by time, amount, or transaction. At the time of the assignment, not only was the amount assigned (*i. e.*, the account receivable on the Texas contract) neither fixed nor earned, but the contingency on which the assignment depended (*i. e.*, the taxpayer's indebtedness to the bonding company) had not yet arisen. In fact, at that time, it was not known whether there would ever be any indebtedness such as subsequently materialized and, if so, what the amount would be; such indebtedness could hardly have even been contemplated since,

[6] The record contains no evidence of any past indebtedness.

[7] The courts below concluded that the phrase encompassed the indebtedness which subsequently arose between the taxpayer and the bonding company in connection with the entirely independent *Kentucky* contract. The Government argued that such a construction is erroneous, particularly when considered in light of the fact that a separate bond indemnifying the bonding company was executed in connection with the *Kentucky* contract. (R. 5, 16.) See *Belton* v. *Bank*, 186 N. C. 614; *Wright* v. *Voorhees*, 131 Ia. 408.

as already pointed out, the bond on the Kentucky contract was not executed until some nine months after the bond on the Texas contract. "Nor can the doctrine of relation back * * * operate to destroy the realities of the situation." *United States* v. *Security Tr. & Sav. Bk.*, 340 U. S. 47, 50.

However, on the basis of Section 3672 (a) of the 1939 Code (Appendix, *infra*, p. 27), the Court of Appeals sustained the bonding company's claim to priority of payment from the interpleaded fund as against the tax liens of the United States. The Court of Appeals, adopting the District Court's reasoning as its own (R. 23), concluded that, although the bonding company "could be said" to come within the classification of a "pledgee," it "more nearly" came within the classification of a "'mortgagee' under the Texas law" and "[we] therefore hold that the Bonding Company under its assignment as collateral security became a 'mortgagee' within the meaning of [Section] 3672 * * *" (R. 11–12, 13).* This, we submit, was error.

Apart from Section 3672, it is clear that the bonding company's claim to priority of payment must fail; for under no circumstances can it be said that the bonding company's interest "attached to the property

* With respect to the "purchaser" category in Section 3672, the District Court stated (R. 11): "* * * I do not rest my decision on this ground since, in the *Scovil* case [348 U. S. 218] the Supreme Court said: 'A purchaser within the meaning of Sec. 3672 usually means one who acquires title for a valuable consideration in the manner of vendor and vendee.'" No claim has ever been made that the bonding company falls within the "judgment creditor" category.

in question and became choate" before the federal tax liens. *United States* v. *New Britain, supra,* pp. 85–86. Section 3672 (a) provides that such federal tax liens "shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector." As this Court stated in the *New Britain* case, *supra,* p. 88, which also involved a claim based on the "mortgagee" clause, there is nothing in the language of Section 3672 to show that Congress intended antecedent federal tax liens to rank behind any but the specific categories of interests set out therein. These specific categories, moreover, are to be defined in their usual and conventional sense and in a uniform manner in all the states. See *United States* v. *Gilbert Associates,* 345 U. S. 361, 364; *United States* v. *Scovil,* 348 U. S. 218, 220–221.[9] As shown below, the taxpayer's assignment to the bonding company does not constitute a "mortgage" (or "pledge") within the meaning of Section 3672 (a),[10] and accordingly the federal tax liens are entitled to priority.

A. THE ASSIGNMENT IS NOT A MORTGAGE WITHIN THE MEANING OF SECTION 3672 (a)

As stated in 4 Pomeroy, *Equity Jurisprudence* (5th ed.), pp. 565–566, a concise definition of mortgage is virtually impossible because of its double character—namely, "that it is both a lien in equity and a con-

[9] See also the concurring opinion of Mr. Justice Jackson in *United States* v. *Security Tr. & Sav. Bk.,* 340 U. S. 47, 52–53, cited in both *Gilbert* (p. 364) and *Scovil* (p. 220).

[10] See note 8, *supra.*

veyance at law." Various definitions, however, have been advanced by the commentators and the courts.

Thus, 1 *Jones on Mortgages* (8th ed.), Section 17, quotes Kent's definition as follows: "A mortgage is the conveyance of an estate by way of pledge for the security of a debt, and to become void on payment of it." In 1 Jones, *Chattel Mortgages and Conditional Sales*, p. 6, the author states that, under either the conveyance of title or creation of lien theory, "a chattel mortgage may be defined as a transfer of some present legal or equitable right in personal property, as security for the payment of money, or for the performance of some other act." 1 *Glenn on Mortgages*, p. 3, gives a modern definition of mortgage as "any form of instrument whereby a lien is created upon real estate or whereby title to real estate is reserved or conveyed as security for the payment of a debt or fulfillment of other obligation."

In *Conrad* v. *Atlantic Insurance Co.*, 1 Pet. 386, 441, it was stated that a mortgage is not only a lien for a debt, but also "it is a transfer of the property itself, as security for the debt." In a later case, *Terrell* v. *Allison*, 21 Wall. 289, this Court pointed out (p. 293) that a mortgage in most states is not regarded as a conveyance, but is treated as a mere lien or encumbrance upon the property as security for the payment of a debt or the performance of some other pecuniary obligation. See to the same effect *Platt* v. *Union Pacific R. R. Co.*, 99 U. S. 48;

cf. *New York* v. *Maclay*, 288 U. S. 290, 294.[11] Thus, in *United States* v. *New Britain*, 347 U. S. 81, 84, this Court described a mortgage as a "specific lien."

In substance, however, a mortgage is but a security for a debt, or an obligation, to which it is collateral. *Brobst* v. *Brock*, 10 Wall. 519, 529. While no precise form of words is necessary to constitute a mortgage, it must evidence a present purpose of the mortgagor to pledge his property for the payment of a sum of money, or for the performance of some other act, or it cannot be construed as a mortgage. *N. O. Nat. Banking Ass'n* v. *Adams*, 109 U. S. 211, 214. Without any debt or obligation secured by it, the mortgage instrument can have no present legal effect as a mortgage; the instrument can only take effect as a mortgage from the time some debt or liability shall have been created. *Ladue* v. *The Detroit & Milwaukee Railroad Co.*, 13 Mich. 380, 397. Moreover, the lien must attach to "specific property" of the debtor. *Illinois* v. *Campbell*, 329 U. S. 362, 373; and see *Conrad* v. *Atlantic Insurance Co.*, 1 Pet. 386, 441. Thus, as Glenn, *supra*, p. 18, points out, a mortgage implies more than a debt or other obligation: "there must also be specific security" and this means "not a promise to furnish collateral, but collateral actually transferred." The author then refers to a promise

[11] This is the rule in Texas. *Humble Oil & Refining Co.* v. *Atwood*, 150 Tex. 617, 624, certiorari denied, 345 U. S. 970. Until foreclosure, title and possession remain in the mortgagor. *In re Thomas*, 36 F. 2d 221 (C. A. 5th); *Willis* v. *Moore*, 59 Tex. 628, 635. An assignment, on the other hand, disposes of the entire property. *Preston* v. *Carter Bros. & Co.*, 80 Tex. 388, 390.

to furnish collateral or security "as creating an equitable mortgage or lien" and adds that use of the adjective "equitable" shows, "that the things which lie in promise are not the same as an *actual mortgage*. The latter requires a transfer or other transaction which results in the lender acquiring *an actual interest*, cognizable at law, *in a definite object of property*." (Emphasis added.)

The assignment transaction with which this case is concerned does not meet this test of an "actual" mortgage. At the time of the assignment, the Texas subcontract was wholly executory and no sums had been earned or were due the taxpayer-assignor thereunder. The taxpayer, therefore, did not own any existing property or have an existing chose in action to offer or transfer to the bonding company as "specific security" for the performance of the contractual obligations or for payment of "other indebtedness." The property here in question—taxpayer's right to the sum of $13,228.53, representing the retained percentages under the contract with the Ball Construction Company—did not come into existence until April 30, 1953, when the work under the Texas subcontract had been performed and accepted.[12]

Furthermore, even on the latter date, there was no debt or obligation in existence which could be the subject of a mortgage. As stated in *Frentel* v.

[12] Of course, where no rule of law is infringed and the rights of third persons are not prejudiced, courts of equity will, in proper cases, give effect to a mortgage of after-acquired property. See, *e. g.*, *Penrock* v. *Coe*, 23 How. 117, 128. Such mortgages, however, constitute only an executory agreement that the future-acquired property shall serve as security from and after the time it comes into existence; otherwise stated, the lien of a mortgage on after-acquired property of the mortgagor

Schmitz, 299 Ill. 320, 323: "A mortgage is security for a debt and without a debt it has no effect as a lien. * * * [T]he lien begins only when money is advanced or the contemplated debt comes into existence in the course of dealing between the parties."[13] Since no debt arose between the taxpayer and the surety until the bonding company was required to

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attaches only when the property comes into existence. See, *e. g.*, *Beall* v. *White*, 94 U. S. 382.

As just pointed out in the text, the after-acquired property here did not come into existence until April 30, 1953. At that very moment, the taxpayer's right to the $13,238.53 became subject to the federal tax lien which had arisen on March 16, 1953. This lien immediately attached to the after-acquired property. *Glass City Bank* v. *United States*, 326 U. S. 265. And, even if there had been an adverse lien which had attached simultaneously, the federal lien would take first. *United States* v. *Graham*, 96 F. Supp. 318, 321 (S. D. Calif.), affirmed *per curiam*, *sub nom.* *State of California* v. *United States*, 195 F. 2d 530 (C. A. 9th), certiorari denied, 344 U. S. 831.

Moreover, even a mortgage of after-acquired property requires a debt (or other obligation) as the subject of the mortgage. Here the debt did not arise until the period between December 1953 and March 1954—long after the federal tax liens had been recorded.

[13] See also 1 *Jones on Mortgages* (8th ed.), pp. 601–602; 3 *Glenn on Mortgages*, Sections 396, 400; *United States* v. *Phillips*, 198 F. 2d 634 (C. A. 5th); *In re New York, S. & W. R. Co.*, 109 F. 2d 988 (C. A. 3d), certiorari denied, 310 U. S. 633; *Ky. Lbr. & Mill W. Co.* v. *Ky. Title S. B. & T. Co.*, 184 Ky. 241; *Ginsberg* v. *Capitol City Wrecking Co.*, 300 Mich. 712, 718; *Kommel* v. *Herb-Giner Const. Co.*, 256 N. Y. 333.

Although, as applied to indemnity mortgages, there is authority (see 1 *Jones on Mortgages*, *supra*, Section 467, and cases cited) holding that the lien of such a mortgage takes effect from the time of its execution and delivery (particularly where an obligation to incur future liabilities exists), such authority has no standing in cases involving federal tax liens for, as this Court has said, the doctrine of relation-back has no application in such cases. *United States* v. *Security Tr. & Sav. Bk.*, 340 U. S. 47, 50.

make payments under the Kentucky bond—between December 1953 and March 1954—no lien or mortgage would have arisen until that time. Prior to that time, however, notices of all the federal liens had been filed. In such circumstances, the federal liens prime any rights of the bonding company to the fund in question.

In fact, prior to the time the indebtedness arose between taxpayer and the bonding company, the assignment agreement was not even a "*caveat* of a more perfect lien to come." Cf. *United States* v. *Security Tr. & Sav. Bk., supra,* p. 50; *United States* v. *Scovil,* 348 U. S. 218, 220; *United States* v. *Waddill Co.,* 323 U. S. 353, 357. *New York* v. *Maclay,* 288 U. S. 290, 294. As in the case of an "open-end mortgage" covering future advances,[14] an indebtedness might never have been incurred under the assignment. The possibility of such an indebtedness was problematical and remote, for it depended on whether the taxpayer defaulted in performance of the Kentucky contract. Until such default took place and the amount of the indebtedness was established, there could be no perfected lien under federal law. This Court has declared it to be the rule that a lien must be definite, not merely ascertainable in the future by taking further steps to perfect it, and that in this sense a lien might be said to be perfected when there is established the identity of the lienor, the property subject to the lien, and the amount of the lien. *Illinois* v. *Campbell,* 329 U. S. 362, 375; *United States* v. *New Britain,*

[14] See note 16, *infra.*

supra, p. 84. Assuming that the identity of the lienor and the property subject to the lien were established, it is clear that the *amount* of the lien was not established, and could not have been established, until the default—long after the intervening federal tax liens arose and were recorded.

In addition, with respect to a mortgage for future advances, it is the general rule that, although the amount of the intended advances need not be stated, nevertheless the contemplated debt must be sufficiently described so that it may be recognized and distinguished from other debts. Otherwise, the mortgage will be void on the ground of uncertainty in the description of the demand or liability intended to be included.[15] As stated in 1 *Jones on Mortgages*, *supra*, p. 595:

> There must be some limit to the amount which the mortgage is to secure, either by express limitation or by stating generally the object of the security.
>
> *If the limit be not defined in any way, it can* be good only for the advances made at the time, and such others as may afterward be made before any other incumbrances are made upon

[15] See 1 Jones, *Chattel Mortgages and Conditional Sales*, *supra*, Sections 86, 95; 1 *Jones on Mortgages*, Sections 425-428, 447, *et. seq.*; *Lawrence* v. *Tucker*, 23 How. 14; *Shirras* v. *Caig*, 7 Cranch 34; *United States* v. *Hooe*, 3 Cranch 73; *Douglass* v. *Reynolds*, 7 Pet. 113; *Townsend* v. *Todd et al.*, 91 U. S. 452; *National Finance Co.* v. *Fregia*, 78 S. W. 2d 1081, 1082 (Tex. Civ. App.); *Allen* v. *Lathrop & Co.*, 46 Ga. 133; *Beach* v. *Osborne*, 74 Conn. 405; *Bowen* v. *Ratcliff*, 140 Ind. 393, 396-397; *Moran* v. *Gardemeyer*, 82 Cal. 96.

> the property mortgaged. A mortgage which merely declares that it is to secure such advances as shall thereafter be made by the mortgagee to the mortgagor, or such indebtedness as shall thereafter arise between them, should, it would seem, be held invalid either as against the policy of the law or as constituting evidence of fraud.

In the instant case, the "other indebtedness," as the assignment is construed by the courts below, is not described or limited in any way, either as to amount, purpose, or time. It therefore can not even be regarded as a valid mortgage for future advances. See *Wright* v. *Voorhees*, 131 Ia. 408, 410–411. A contrary holding would only invite the use of such assignments for the perpetration of fraud upon creditors, including the United States. *New* v. *Sailors*, 114 Ind. 407, 410; *Pettibone* v. *Griswold*, 4 *Conn.* 158, 162.

Moreover, Section 3672 (a) affords no protection, we believe, to mortgages for future advances, but rather only mortgages securing existing debts.[16] Until an advance is actually made, there can be no fixed and specific or perfected lien under federal law as dis-

[16] This is the position taken by the Internal Revenue Service in a recent ruling. Rev. Rul. 56–41, 1956–1 Cum. Bull. 562. There the Service was requested to rule whether an advance of money by a mortgagee under an "open-end mortgage" subsequent to the original loan had priority over an intervening recorded federal tax lien. An "open-end mortgage" was described as a mortgage with a future advance clause providing for increasing an existing mortgage debt—the loan or advance subsequent to the original loan being secured by the same mortgage.

tinguished from a mere contingent lien or "caveat of a more perfect lien to come," and consequently an intervening recorded federal tax lien should have priority over advances made subsequent to the date of such recording. The correctness of this position is reflected in several decisions of this Court where actual adverse liens—far more specific than the bonding company's interest here—have been held subordinate to perfected federal tax liens, even where the adverse liens arose prior to the federal liens.

Thus, in *United States* v. *Security Tr. & Sav. Bk.*, 340 U. S. 47, federal tax liens recorded prior to the time a statutory attachment lien was perfected by judgment were held entitled to priority. In its opinion, this Court pointed out (p. 50) that "numerous contingencies" might arise which would prevent the attachment lien from ever becoming perfected by judgment, and consequently that the attachment lien was inchoate. The principles of the *Security Tr. & Sav. Bk.* case, *supra,* were also applied by this Court in *United States* v. *Acri,* 348 U. S. 211, which also involved a statutory attachment lien; in *United States* v. *Liverpool & London Ins. Co.,* 348 U. S. 215, involving a statutory garnishment lien; in *United States* v. *Scovil,* 348 U. S. 218, involving a statutory landlord's distress lien; and in *United States* v. *Colotta,* 350 U. S. 808, and *United States* v. *White Bear Brewing Co.,* 350 U. S. 1010, both of which involved statutory mechanics liens.

The court below sought to distinguish the cited cases, as well as *United States* v. *Gilbert Associates,* 345 U. S. 361, and *United States* v. *New Britain,* 347

U. S. 81, both of which dealt with adverse municipal tax liens, on the ground that (R. 10) the liens involved in those cases "arose by virtue of some statutory right, not specifically referred to in Section 3672," whereas the liens of a "mortgagee,"[17] "pledgee," or "purchaser" "are all based upon a contract right of some sort." The attempted distinction, however, is based upon a misconception of the purpose and function of Section 3672. That section was originally enacted in 1913 (37 Stat. 1016) as an amendment of Revised Statutes, Section 3186, and was occasioned by the decision of this Court in *United States* v. *Snyder*, 149 U. S. 210. See S. Rep. No. 1315, 62d Cong., 3d Sess. The *Snyder* case held that the tax lien created by Section 3186 was valid even as against a bona fide purchaser or incumbrancer in good faith, though he had no notice of the tax delinquency of the person through whom he acquired his title or lien. The purpose of the 1913 amendment was to protect a mortgagee, purchaser, or judgment creditor[17] against this comprehensive secret lien of the United States, by providing that it should not be valid as against such persons until recorded. Section 3672, therefore, is merely a recordation statute enacted to give the particular classes of lienors specified therein notice of the existence of a federal tax lien. See *United States* v. *Security Tr. & Sav. Bk.*, *supra*, pp. 51–53 (concurring opinion). It was not designed or intended to make any exception to the rule that a perfected

[17] The term "pledgee" was added to Section 3672 of the Internal Revenue Code of 1939 by Section 401 of the Revenue Act of 1939, c. 247, 53 Stat. 862.

tax lien is entitled to priority as against an inchoate lien, and there certainly is no basis for assuming, as did the court below, that in enacting Section 3672 Congress intended different priority standards to apply to the designated nonstatutory liens than to statutory liens.

In this case, as already shown, the advances for which the bonding company seeks "mortgagee" status were not made until several months after the federal liens had been recorded. Prior to the recording of the federal liens, there was at most a mere possibility that the taxpayer might become indebted to the bonding company. Such a mere possibility is plainly insufficient to constitute a specific lien under this Court's decisions (*supra*, p. 19). For like reasons, such a mere possibility is insufficient to entitle the bonding company to the status of a "mortgagee" under Section 3672. "Nor can the doctrine of relation back * * * operate to destroy the realities of the situation." *United States* v. *Security Tr. & Sav. Bk.*, *supra*, p. 50. The bonding company therefore is hardly in the position of a bona fide purchaser or incumbrancer who in good faith makes advances without notice of a secret lien of the United States. In the situation involved here, the purpose and function of Section 3672 (see *supra*, p. 20) have no application.

B. THE ASSIGNMENT IS NOT A PLEDGE WITHIN THE MEANING OF SECTION 3672 (a)

As previously pointed out, the courts below were of the view that, by virtue of the assignment, the bonding company "could be said" to come within the classification of a "pledgee" under Section 3672 (a),

although the decision was specifically placed on the ground that the bonding company was a "mortgagee."

Whether a particular instrument be a mortgage or pledge, the purpose of the instrument is the same—to secure the payment of money, or the performance of some act by the maker of the instrument. There is, nevertheless, a well-recognized distinction between the two. Not only must a pledge secure a debt or other obligation, but furthermore it must be accompanied by a transfer of possession of the property or collateral pledged as security. *Casey* v. *Cavaroc*, 96 U. S. 467;[18] *Third Nat. Bank* v. *Buffalo German Ins. Co.*, 193 U. S. 581, 588; *Security Warehousing Co.* v. *Hand*, 206 U. S. 415, 421; *Dale* v. *Pattison*, 234 U. S. 399; *Bostian* v. *Park National Bank*, 226 F. 2d 753, 756 (C. A. 8th); *First National Bank* v. *McCamey*, 130 Tex. 148, 152; *Central Nat. Bank* v. *Latham & Co.*, 22 S. W. 2d 765 (Tex. Civ. App.); 1 Jones, *Chattel Mortgages and Conditional Sales*, *supra*, pp. 10–12; and 10 Am. Jur., *Chattel Mortgages*, Section 10, pp. 723–724. In the *Cavaroc* case, *supra*, where this Court distinguished a mortgage and a pledge, it said (p. 477): "Indeed, possession may be considered as of the very essence of a pledge * * *." And later in the *Security Warehousing Co.* case, *supra*, it stated (p. 421): "The general law of pledge requires possession, and it cannot exist without it." Of course, where the property or collateral is from its character or situation incapable of actual delivery, there may be a constructive or sym-

[18] See also *Casey* v. *Schuchardt*, 96 U. S. 494, and *Casey* v. *Schneider*, 96 U. S. 496.

bolic transfer of the property and right to possession *Dale* v. *Pattison, supra,* pp. 408–409; *Casey* v. *Cavaroc, supra,* p. 477.

At the time the assignment in the instant case was executed, taxpayer was not entitled to receive the retained percentages and hence had nothing which could be the subject of a present assignment or pledge. And, in order to have an "equitable" assignment there would have to be such an appropriation of the retained percentages that the holder of the fund (Ball) would be authorized to pay the amount directly to the creditor; more succinctly stated, "an equitable assignment can be effected only by surrender of control over the funds or property assigned." *Central Nat. Bank* v. *Latham & Co., supra,* p. 767. Here, there was no order of appropriation of the funds or any evidence of surrender of control over them. Viewed as a contract of pledge, the agreement remained wholly executory. *Third Nat. Bank* v. *Buffalo German Ins. Co., supra.*

In fact, insofar as concerns the bonding company, Ball was entirely free to pay over the retained percentages to the taxpayer when the Texas contract was completed and accepted on April 30, 1953. As stipulated (R. 2–3) and found by the trial court (R. 8), those retained percentages were "due and owing" to the taxpayer on that date. Except for the fact that shortly thereafter Ball was presented with notices of claims of creditors of the taxpayer (R. 3–4, 8–9), those funds could have been paid to the taxpayer in the ordinary course of events long prior to the time

any indebtedness arose in connection with the Kentucky contract.

In addition, what has been said above with reference to a mortgage (*supra*, pp. 11–21) is equally applicable to show that the bonding company was not a "pledgee" as that term is used in Section 3672 (a).

II

THE COURT BELOW ERRED IN ALLOWING A FEE FOR THE INTERPLEADER'S ATTORNEY OUT OF THE FUND IMPRESSED WITH THE FEDERAL TAX LIENS

The fund in question was paid into court by the Ball Construction Company, which named as parties the taxpayer, the United States, the bonding company, and certain suppliers of materials and services. In its complaint, Ball asked for the allowance of an interpleader's attorney's fee payable from the fund. It was stipulated among the parties that, if such a fee were allowable, $500 was a reasonable amount. (R. 4, 8.)

The courts below held that the fee was allowable and that Ball's right to the fee was superior to the tax liens asserted by the United States and to the claim of the bonding company. (R. 19.)[12] In so holding, the courts sought to distinguish the decision of this Court in *United States* v. *Liverpool & London Ins. Co.*, 348 U. S. 215, on the ground that (R.

[12] It is to be noted that the interpleaded fund involved here exceeds the amount claimed by the bonding company, and hence that, even if the bonding company's claim were entitled to priority (as the courts below held), over half of the fund awarded to the interpleader's attorneys was at the expense of the Government.

14) it "had to do solely with a garnishee's fee under Rule 677 of the Texas Rules of Civil Procedure and did not purport to deal with an interpleader action under Texas Rule 43 or Rule 22 of the Federal Rules of Civil Procedure."

But the fact is that, although the *Liverpool* case grew out of a garnishment proceeding, both the Fifth Circuit (209 F. 2d 684, 686) and this Court (p. 216) regarded it an "interpleader action." Moreover, in *Liverpool* as here, the "interpleader action" had been removed from a Texas state court to a United States District Court (*ibid.*). In *Liverpool,* this Court concluded (p. 217) that "* * * certainly fees allowed in that proceeding are not prior to the Government liens, and the authorization of the payment of the attorney's fees prior to the Government liens was error."

That holding would appear to be fully dispositive here.[20]

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[20] The case of *United States* v. *Ullman*, 115 F. Supp. 241 (E. D. Pa.), which the court below followed, was decided prior to this Court's decision in the *Liverpool* case. Moreover, the *Ullman* case is not "directly in point," as was held below (R. 14), since there the United States had instituted the suit to foreclose its income tax liens. The *Ullman* case is distinguished in *Ford Motor Co.* v. *Hackart Construction Co.*, 143 F. Supp. 216 (N. J.), where it is pointed out that the decision in the *Ullman* case did not purport to resolve a conflict between a government lien and an allowance of fees since the question of priorities of interest in the interpleaded fund had not been reached. The decision of this Court in the *Liverpool* case was also followed in *Bruce* v. *United States*, 127 F. Supp. 858 (E. D. Mich.), and *Boston Insurance Co.* v. *Stubbs* (W. D. Wash.), decided March 20, 1956 (1956 C. C. H., par. 9695).

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment below should be reversed.

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APPENDIX

Internal Revenue Code of 1939:

SEC. 3670. PROPERTY SUBJECT TO LIEN.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U. S. C., 1952 ed., Sec. 3670.)

SEC. 3671. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time.

(26 U. S. C., 1952 ed., Sec. 3671.)

SEC. 3672 [as amended by Sec. 401 of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Sec. 505 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien without Notice:*—Such lien shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector—

(1) *Under state or territorial laws.*—In the office in which the filing of such notice is authorized by the law of the State or Territory in which the property subject to the lien is

situated, whenever the State or Territory has by law authorized the filing of such notice in an office with the State or Territory; or

* * * * *

(26 U. S. C., 1952 ed., Sec. 3672 (a).)

1 Vernon's Civil Statutes of the State of Texas, Annotated:

ART. 260–1. *Accounts and accounts receivable; notices; records*

SECTION 1. Definitions: In this Act, unless the context otherwise requires:

(1) "Account" or "account receivable" means an existing or future right to the payment of money presently due, or to become due (a) under an existing contract: * * *

* * * * *

(4) "Assignment" means any transfer of an account, other than by operation of law, including but not limited to a transfer as security, the creation by agreement of a lien on an account, and sales of accounts.

SEC. 2. The assignment of any account or accounts may be protected by the execution and delivery by the assignor to the assignee of an instrument or instruments in writing, assigning such account or accounts and describing the account or accounts assigned with sufficient particularity to identify the same, and by the filing for record the "Notice of Assignment" as hereinafter provided for.

* * * * *

SEC. 6. Whenever any person, firm or corporation shall in good faith take a protected assignment of any account or accounts, which shall not have been satisfied, cancelled or released by the assignor, all creditors of, and all subsequent assignees, purchasers and transferees of or from the assignor shall be conclusively deemed to have received notice of such assignment, dating from the time of the filing

for record of the notice of assignment hereinabove provided; and after such filing for record, no purchaser from the assignor, no creditor of any kind of the assignor, and no prior or subsequent assignee or transferee of the assignor, holding an assignment not protected, or holding an assignment under a notice of assignment subsequently filed for record, shall in any event have, or be deemed to have acquired, any right in the account or accounts so assigned or in the proceeds thereof, or in any obligation substituted therefor, superior to the rights therein of the assignee named in such prior protected assignment.

* * * * *

Acts 1945, 49th Leg., p. 463, ch. 293.

16 Vernon's Civil Statutes of the State of Texas, Annotated:

ART. 5490. *Chattel mortgages*

Every chattel mortgage, deed of trust, or other instrument of writing, intended to operate as a mortgage, or lien upon personal property, and every transfer thereof which shall not be accompanied by an immediate delivery and be followed by an actual and continued change of possession of the property mortgaged, pledged, or affected by such instrument, shall be absolutely void as against the creditors of the mortgagor or person making same, as against subsequent purchasers and mortgagees or lien holders in good faith, unless such instrument, or a true copy thereof, shall be forthwith deposited with and filed in the office of the county clerk of the county where the property shall then be situated, or if the mortgagor or person making the same be a resident of this State, then, of the county of which he shall at that time be a resident; * * *.

Acts 1925, 39th Leg., p. 368, ch. 157.